2020 COST OF CAPITAL – SOCALGAS [A.19-04-018]
PUBLIC ADVOCATES DATA REQUEST
DR-PA-01
DATE RECEIVED: JUNE 11, 2019
DATE RESPONDED: JUNE 28, 2019

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1. Please provide a copy of the bond indentures of all currently active bond indentures for the debt issuances of SoCalGas and for the debt issuances of Sempra.

Response 1:

SoCalGas objects to the question to the extent it seeks information regarding Sempra Energy that is not relevant and outside the scope of this proceeding, as Sempra Energy's debt financing activities are outside the scope of the utility's cost of capital proceeding, and Sempra Energy is not party to this proceeding. Subject to and without waiving this objection, SoCalGas responds as follows.

The prospectus/prospectus supplements which are filed with the Securities and Exchange Commission (SEC) provide detailed information with respect to SoCalGas's active debt issuances. All prospectus filings can be found at:

https://www.sec.gov/cgi-bin/browse-edgar?company=southern+california+gas&owner=exclude&action=getcompany

Note: With respect to each bond issuance listed on the website, there are three filings: 424B2, 424B5, and FWP. The relevant and informative document filing is the 424B2, which is the prospectus/prospectus supplement. The filing 424B5 is only a preliminary shell of the 424B2 filing and would not be useful. The FWP filing is a summary-level Final Term Sheet, which may also contain relevant information.

Bond indenture documents may be old and would not contain the detailed information contained in the prospectus/prospectus supplement filings. One document that pre-dates the Edgar's online system is attached separately.

2. Please provide a copy of all the major bond rating agency reports that cover SoCalGas, Sempra, and all other subsidiaries of Sempra, that were issued over the last five years.

Response 2 (PROTECTED MATERIALS):

SoCalGas objects to the question to the extent it seeks information regarding Sempra Energy and/or its other affiliates that is not relevant to SoCalGas's cost of capital request and outside the scope of this proceeding. Further, neither Sempra Energy nor its non-regulated affiliates are parties to this proceeding. Moreover, the request is overbroad and unduly burdensome in asking for five years of reports from the rating agencies. Subject to and without waiving these objections, SoCalGas responds as follows.

The three credit rating agencies (Moody's, S&P, and Fitch) publish materials that are available on a subscription basis, and subject to their respective copyright and other proprietary protections. In the interest of not inadvertently violating those protections, SoCalGas can provide reports that it consulted in the preparation of its cost of capital application from those rating agencies. In addition, SoCalGas has two Moody's reports, one S&P report, and one Fitch report recently published (after the application was filed), that will be provided. Reports or publications from these rating agencies that are publicly available will bear the designation "(public)" in the filename. The rest of the files will be provided pursuant to PUC §583 and the confidentiality declaration.[1]

In addition, direct links to utility industry pages at each respective agency is provided below in which analysis, reports and commentary is available or a request for access can be made to view the materials.

<u>US Utility and Power Sector</u>:

Moody's:
https://www.moodys.com/researchandratings/market-segment/u-s-public-finance/power-gas-utilities/005003007/005003007/-/-1/0/-/0/-/-/-/-/-/-/-/-/global/pdf/-/rra

[1] These credit rating agency files were provided in response to a data request from the Indicated Shippers (DR-IS-01). The reports or publications that were provided under a Non-Disclosure Agreement bear the header "PROTECTED MATERIALS – PROVIDED PURSUANT TO NDA." As these same files are being provided to Public Advocates in response to this question, and to avoid having to relabel the header for the identical files, SoCalGas retains the original header, which should indicate to Public Advocates that those files are subject to PUC §583 and the confidentiality declaration and should be protected from public disclosure.

Fitch:
https://www.fitchratings.com/site/search?content=research&filter=MARKET%20SECTOR%5ECorporate%20Finance%5EGlobal%20Power%2BGEOGRAPHY%5EUnited%20States

Natural Gas and Propane subsector:
https://www.fitchratings.com/site/search?content=research&filter=MARKET%20SECTOR%5ECorporate%20Finance%5EGlobal%20Power%5ENatural%20Gas%20%26%20Propane%2BGEOGRAPHY%5EUnited%20States

S&P:
Access Request:
https://www.standardandpoors.com//en_US/web/guest/home

Utility Sector Link:
https://www.spratings.com/en_US/u.s.-public-finance?p_p_id=122_INSTANCE_GA3DTNLq5ZQX&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&p_p_col_id=column-1&p_p_col_count=2&p_r_p_564233524_resetCur=true&p_r_p_564233524_categoryId=88380,1

3. According to Value Line, the capital structure of Sempra contained 38.4% common equity as of the end of 2018.

a. Please explain why the capital structure of Sempra has been managed to contain a smaller percentage of common equity in its capital structure than is requested for SoCalGas.

b. Please provide the capitalization of each of the subsidiaries of Sempra as of 12/31/18, both in terms of dollar amount by type of capitalization and in term of the percentage of each type.

c. Please explain how it was decided what percentage of common and preferred equity should be used by each of the Sempra companies.

d. Please compare the business risk of each of the subsidiaries of Sempra.

e. Please provide a statement showing how the capital structure amounts from each Sempra subsidiary combine to form the consolidated Sempra capital structure.

Response 3:

SoCalGas objects to the question to the extent it seeks information regarding Sempra Energy and/or its other affiliates that is not relevant to SoCalGas's cost of capital request and outside the scope of this proceeding. Further, neither Sempra Energy nor its non-regulated affiliates are parties to this proceeding. Subject to and without waiving these objections, SoCalGas responds as follows.

a. See objections above.

b. The capitalization of SoCalGas as of 12/31/18 in millions of dollars:

Common Equity	$4.237
Preferred Equity	0.021
Long-Term Debt	3.456
Total Capitalization	**$7.714**

The total SoCalGas capitalization makes up approximately 17% of Sempra Energy's total capitalization.

c. As explained in Exhibit SCG-02 (Gonzalez), SoCalGas actively manages its capital structure to maintain strong credit ratings, support access to the markets, and manage financial and business risk. SoCalGas's proposed capital structure is aligned with its average recorded capital structure and is aimed at achieving these objectives in light of current market conditions, regulatory environment, and changing gas industry.

d. The business risks of SoCalGas are discussed in detail in Exhibit SCG-03 (Aragon).

e. The capital structure of SoCalGas as of 12/31/18 is shown in the table provided in response to Question 3(b) above.

4. Is there any "ring fencing" around any of the Sempra subsidiaries to contain liabilities in the event of financial troubles at any one of the subsidiaries?

   a. If yes: please state which ones have the ring fencing. Provide the documentation that shows this ring fencing exists.

Response 4:

SoCalGas objects to the question to the extent it seeks information regarding Sempra Energy and/or its other affiliates that is not relevant to SoCalGas's cost of capital request and outside the scope of this proceeding. Further, neither Sempra Energy nor its non-regulated affiliates are parties to this proceeding. Subject to and without waiving these objections, SoCalGas responds as follows.

SoCalGas has ring fencing to contain liabilities in the event of financial troubles at Sempra Energy. See separately attached file.

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5. What does Dr. Morin believe is the beta of a long-term U.S. treasury bond?

   a. Please provide the basis for his answer.

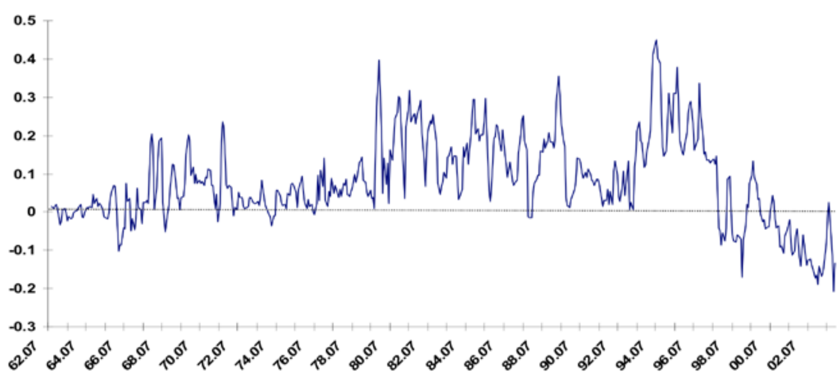
   b. Does Dr. Morin believe that the beta for a long-term U.S. treasury bond is higher than for a short-term U.S. treasury note? If not, please explain why not.

Response 5:

Dr. Morin believes that U.S. treasury bond betas are effectively zero regardless of maturity. This is based on a comprehensive study by Israel, Pahlhares, and Richardson published in the second quarter of 2018 edition of the Journal of Investment Management "*Common Factors in Corporate Bond Returns*." As seen below from Figure 1 from that study, the average beta of Treasury bonds is effectively zero.

Figure 1
CAPM beta of bonds
(1962.07-2003.12)

Realized beta of bonds based on 3-months of daily returns on stocks and bonds.



See separately attached file.

6. In Dr. Morin's ten most recent cost of capital testimonies, please state:

   a. In which ones did he add a risk premium to increase his cost of equity recommendation above the cost of equity he found for his surrogate companies?

   b. In which ones did he make a reduction for a lower risk premium than the surrogate companies?

   c. In which ones did he propose no increase or decrease in the risk premium?

Response 6:

a. SDG&E FERC Docket No. ER19-221-000
   SDG&E, CPUC, Docket A.19-04-017
   SoCalGas, CPUC, Docket A.19-04-018
   Duke Energy Kentucky, Case No. 2017-00321
   Iowa-American Water Company, Iowa, Docket No. RPU-2016-0000
   Missouri American Water Company, Missouri, Case No. WR-2015-0301

b. Dr. Morin has not testified recently on behalf of utilities that are less risky than the surrogate companies, such as distribution utilities.

c. OG&E
   PSE
   Duke Energy Kentucky, Case No. 2015-00089
   Interstate Power & Light, Iowa, Docket No. RPU-2018-0002
   Interstate Power & Light, Iowa, Docket No. RPU-2019-0001
   Oklahoma Gas & Electric, Oklahoma, Cause No. PUD 201800140
   Duke Energy Ohio, Case No. 14-841-EL-SSO
   Duke Energy Ohio, Case No. 14-842-EL-ATA
   Puget Sound Energy Inc. Docket No. UE-121697/UG-121705
   Puget Sound Energy Inc. Docket No. UE-130137/UG-130138
   Duke Energy Ohio, Case No. 17-0032-EL-AIR

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7. Please provide a copy of the two most recent cost of capital testimonies submitted by Dr. Morin in which he recommended a reduction in the risk premium for the subject company, as compared to the cost of equity for the surrogate companies.

Response 7:

See response to Question 6(b) above. There are no recent testimonies.

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8. With reference to page 6, line 17, of Dr. Morin's testimony: Dr. Morin discusses potential dilution if the company should issue new common stock when the market to book ratio is too low.

a. Does Dr. Morin agree that if new common stock is issued at a price below the company's pre-issue book value, then the issue results in a decline in the company's book value?

b. Does Dr. Morin agree that if the company sells new common stock at a price with a net proceeds in excess of the pre-issue book value, the new issue has the opposite effect from dilution (i.e. the result of the issuance would be to increase the book value per share)?

c. What return on book equity does Dr. Morin believe the investors in SoCalGas would have to expect to be able to earn so that its common stock price would most likely sell at book value?

Response 8:

a. Yes, all else remaining constant.

b. Yes, all else remaining constant.

c. Notwithstanding the fact that SoCalGas is not a publicly-traded stock, Dr. Morin is not privy to what investors would expect should the company's stock price sell at book value.

9. With reference to page 22 of Dr. Morin's testimony: please provide a copy of all of the studies relied upon by Dr. Morin to make his statement on page 22, at lines 7 to 10, that "… empirical finance literature demonstrates that the sustainable growth method of determining growth is not significantly correlated to measures of value, such as stock prices and price/earnings ratios as analysts' growth forecasts."

Response 9:

See separately attached file.

10. With reference to page 22 of Dr. Morin's testimony:

a. Does Dr. Morin agree that changes in the portion of earnings paid out as dividends per share can have a significant influence on the future rate at which earnings per share can grow?

b. If the answer to (a), above, is no, please explain why Dr. Morin disagrees.

c. Does Dr. Morin agree that changes in the portion of earnings paid out as dividends per share can have a significant impact on the future dividend yield investors will receive?

d. If the answer to (c), above, is no, please explain why Dr. Morin disagrees.

Response 10:

a. Yes.

b. See (a).

c. Yes.

d. See (c).

11. With reference to page 23, lines 2 through 9 of Dr. Morin's testimony:

   a. Please state from what starting period to what ending period the earnings per share forecast to derive the 7.84% average from Value Line are made.

   b. Provide supporting data to show specifically what time period is used by each source.

Response 11:

As shown in the Value Line reports for each company in the peer group, Value Line growth rates are estimated to 1921-1923. To compute smoothed compound growth rates, base periods used by Value Line are 3-year averages in order to temper cyclicality and reduce sensitivity to end points. As seen from the Value Line Investment Guide available on its web site, base periods for the 5-year growth rate calculations through the end of are 2021-2023 versus 2015-2017.

12. With reference to page 27 of Dr. Morin's testimony:

    a. Please state from what starting period to what ending period each of the earnings per share forecasts used to derive the 6.40% growth rate are made.

    b. Provide documentation supporting this answer.

Response 12:

Analyst Growth rates tabulated in the Yahoo Finance database are defined as "next five years." See Yahoo Finance web site for support.

13. With reference to page 26, line 17 of Dr. Morin's testimony:

a. What earned return on book equity does Dr. Morin think investors have to expect for the 7.84% growth rate to be achieved?

b. From when to when is the "long-term growth" period supposed to start and end, that is consistent with Dr. Morin's computations?

c. Please provide documentation to support this answer.

Response 13:

a. As seen in the Value Line reports for each company in the peer group, Value Line also publishes its estimate of investor expected return in 2021-2023 to match the estimated growth rate. The table below shows the expected returns for the natural gas distribution group.

Company	2021-2023 Expected Return
Atmos	11.0%
NJ Res	13.0%
NISource	11.5%
Northwest Nat Gas	12.0%
ONE Gas	11.0%
So Jersey Ind	11.5%
Southwest Gas	9.5%
Spire	10.0%
UGI	12.0%

Source: Value Line 1/19

b. See response to Question 11.

c. See response to Question 11.

14. With reference to page 28, lines 12-13 of his testimony: Dr. Morin states that his group of combination electric and gas utilities contain at least 50% of their revenues from regulated operations.

a. What is the percentage of revenues from regulated operations for each of the companies in this group, and the overall group average?

b. What is the percentage of income for each of the companies in this group that is derived from regulated operations?

c. For each company in this group, what is the percentage of revenues and income that is derived from regulated gas distribution utility operations?

Response 14:

See separately attached spreadsheet, which was used as the basis for the Dr. Morin's statement regarding the 50% figure.

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15. With reference to Dr. Morin's discussion of the DCF method and proxy groups, beginning on page 23:

a. If the unregulated operations of the group of dual-commodity gas and electric utilities have a higher risk than these utilities' regulated operations, would the resultant DCF analysis of this group produce a higher cost of equity than would be appropriate for the lower-risk segment of the business of these companies?

b. If the answer to (a), above, is no, please explain why not.

c. Has Dr. Morin conducted any analysis to determine how the risk of the unregulated operations of these companies compares to the risk of the regulated portion of these businesses?

d. If yes, please provide a copy of all such studies.

Response 15:

a. Yes, and the converse would be true as well.

b. N/A.

c. The risk analysis of the unregulated operations of each utility in the peer group is outside the scope of Dr. Morin's testimony, and is largely unnecessary given the vast preponderance of the revenues from regulated operations for these companies and given that these companies are perceived by investors as regulated utilities.

d. N/A.

16. With reference to the table on the top of page 9 of Appendix A from Dr. Morin's testimony:

a. Please state how many companies are included in each group.

b. Please state how many of the nearly 2,000 companies were excluded from inclusion in any group and why each was excluded.

c. Please state if the 10-year returns shown in this table were average annual returns or compound annual (geometric) returns. Please provide a copy of this table, including a new column that shows what the returns would have been if the alternative (i.e., average annual or compound annual) had been used instead.

d. Is the beta in the table the beta at the beginning of the period, at the end of the period, or average for the period? If not one of these, please state what is represented by the beta that is shown.

e. Were the betas obtained from Value Line? If not, please state what source was used and why that source was used.

Response 16:

a. Approximately 2,000 companies.

b. None were excluded.

c. The returns were average annual returns. Dr. Morin does not have access to the compound annual returns as this was unnecessary for his analyses.

d. The betas were average betas for the period, obtained from Value Line.

e. See response to (d).

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17. With reference to page 9 of Appendix A of Dr. Morin's testimony: the discussion of HMMO data includes results "… by using a constant growth DCF model." Please explain in detail how growth was computed in this version of the constant growth DCF model.

Response 17:

Please refer to the separately attached file containing the HMMO study for the computational details of the DCF estimates.

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18. With reference to the historical risk premium method presented by Dr. Morin in his SoCalGas testimony, including at page 48 and following:

a. Please provide the percentages of income and revenues in the S&P Utility Index that were related to operations not subject to rate regulation. Please provide this information for as many years back as available.

b. Please provide a breakdown of the S&P Utility index by type of utility showing the revenues, income, and net book value by each industry for as many years back as the information is available.

c. Please provide the market to book value ratio for the overall S&P Utility Index by year for as many years as the information is available.

d. Please state what analysis, if any, was conducted by Dr. Morin to determine how satisfied investors were with the historical earnings of the S&P Utilities for each year in which the information is available.

Response 18:

Dr. Morin did not rely on this information to arrive at his return recommendation. Even had he done so, Dr. Morin does not believe such information is available for each year going back some 90 years to 1931 for each company in the S&P Utility Index, and whose year-to-year composition of companies in the index has evolved markedly over the past 90 years.

19. With reference to Table 7 on page 66 of Dr. Morin's testimony:

a. Please provide a copy of the Moody's report from which this table was obtained.

b. Did Dr. Morin do any studies to determine of the Moody's benchmarks were consistent with what Moody's awards for bond ratings for regulated gas utilities? If yes, please provide a copy of any such studies.

Response 19 (PROTECTED MATERIALS):

a. The Moody's Report will be provided pursuant to PUC §583 and a confidentiality declaration due to the information being third-party proprietary property.

b. Dr. Morin did not analyze the consistency between Moody's financial metrics benchmarks and its awards for the bond ratings of natural gas utilities as this was completely outside the scope of Dr. Morin's testimony which deals with utility common stocks rather than bonds.

20. Please provide the current cost of short-term debt to SoCalGas and explain how this cost is determined (e.g., a certain percentage over the LIBOR rate).

Response 20:

SoCalGas objects on the basis that the question seeks information that is not relevant and out of scope of the proceeding (see response to Question 21). Subject to and without waiving these objections, SoCalGas responds as follows.

SoCalGas typically raises short-term debt in the commercial paper market. SoCalGas can currently access commercial paper at rates ranging from 2.43% for overnights to 2.50% for one-month maturities. During the first quarter of 2019, the weighted average commercial paper rate was 2.46%. The commercial paper rate is determined by supply and demand in the money markets and is influenced by several factors, including those impacting the global economy, U.S. monetary and fiscal policy, etc. While it is generally correlated with the LIBOR rate, it is not tied to it.

21. Please explain why SoCalGas has not recommended the inclusion of any short-term debt in its capital structure.

Response 21:

As explained in Exhibit-02 (Gonzalez), p. 20:

> Long-term financing provides a static, dependable source of funds with known maturity dates. By contrast, the customer deposit balances can fluctuate and are not permanent in nature, thus lacking the same characteristics as long-term financing.
>
> Financial principles provide that short-term assets should be financed with short-term liabilities and long-term assets should be financed with long-term liabilities. Customer deposits are short-term and refunded after 12 months. Therefore, customer deposits should not be included as part of Long-Term Debt in SoCalGas' capital structure which would be used to finance long-term assets, such as rate base assets.

It would be inappropriate to include Short-Term Debt as part of the Long-Term Debt ratio of the utility's capital structure because it is not meant to fund the company's long-term fixed assets.

Further, in D.12-12-034 (p. 5), the Commission stated, "Capital structure consists of long-term debt, preferred stock, and common equity," and noted (in FN 7), "Debt due within one year, short-term debt, is excluded."

22. Please provide the average balances of:

a. Short-term debt used by SoCalGas for 2017, 2018, and projected for the Test Year.

b. CWIP earning AFUDC for SoCalGas for 2017, 2018, and projected for the Test Year.

Response 22:

SoCalGas objects on the basis that the question seeks information that is not relevant and out of scope of the proceeding (see response to Question 21). Subject to and without waiving these objections, SoCalGas responds as follows.

a. The monthly average balance of Short-Term Debt used by SoCalGas for 2017 and 2018 were $32 million and $204 million, respectively.

b. In general, allowance for funds used during construction (AFUDC) is applied monthly during construction work-in-progress (CWIP) to capital projects that will result in plant assets. However, there are some exceptions in which AFUDC is not applied. The amount of CWIP that receives AFUDC versus the amount that does not receive AFUDC is not readily available and would be unduly burdensome to calculate.

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23. Please provide a schedule showing the percentage of Sempra's revenues, net income available to common equity, interest expense, and cash flow were derived from SoCalGas, SDG&E, and each other subsidiary of Sempra for each of the five years ended 2018.

Response 23:

SoCalGas objects to the question to the extent it seeks information regarding Sempra Energy and/or its other affiliates that is not relevant to SoCalGas's cost of capital request and outside the scope of this proceeding. Further, neither Sempra Energy nor its non-regulated affiliates are parties to this proceeding. Subject to and without waiving these objections, SoCalGas responds as follows.

Please see the table below for SoCalGas's percentage of Sempra Energy's revenues, net income available to common equity, interest expense, and cash flows as derived from SoCalGas's and Sempra Energy's annual 10-K Reports.

	2018		**2017**		**2016**		**2015**		**2014**	
($ in Millions)		**% of Total SE**		**% of Total SE**		**% of Total SE**		**% of Total SE**		**% of Total SE**
Revenues	$3,962	34%	$3,785	34%	$3,471	34%	$3,489	34%	$3,855	35%
Net Income	$ 400	43%	$ 396	155 %	$ 349	25%	$ 419	31%	$ 332	29%
Interest Expense	$ 115	12%	$ 102	15%	$ 97	18%	$ 84	15%	$ 69	12%
Cash Flow	$ 18	7%	$ 8	2%	$ 12	3%	$ 58	14%	$ 85	15%